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IN THE

Supreme Court of the United States

October Term, 1958
No. 981

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of GEORGE MILLER, Deceased,
Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit After Judgment in a Bankruptcy Proceeding.

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No. .....

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ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of GEORGE MILLER, Deceased,

Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit After Judgment in a Bankruptcy Proceeding.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners pray that a Writ of Certiorari issue to review the decision and judgment of the United States Court of Appeals for the Ninth Circuit affirming the interlocutory order of the United States District Court in the bankruptcy Matter of Delcon Corporation, Bankrupt, pending in the District Court of the United States, Southern District of California, Central Division. The aforesaid interlocutory order of the District Court reversed the decision and order of the Referee in Bankruptcy.

whose decision demonstrates a thorough and scholarly exploration and analysis of the pertinent sections of the Bankruptcy Act in the light of the equity principles rooted in the philosophy of the Bankruptcy Act. The Referee was brought to the conclusion that the facts on which the decision of this Honorable Court in *Moore v. Bay*, 284 U. S. 4, 52 Sup. Ct. Rep. 3, 76 L. ed. 133, was predicated were not analogous or parallel with the legal and *equitable problem presented by the present record.*[1]

Introductory Statement.

Petitioners (referred to herein as Millers) are the owners and holders of a purchase price chattel mortgage on a manufacturing plant and business in Los Angeles, California sold by petitioners to Delcon Corporation (called Delcon) on June 1, 1954. The chattel mortgage was executed and delivered by Delcon to petitioners on June 1, 1954, *more than eight months preceding bankruptcy;* and due to the dishonesty of a trusted employee of petitioners the chattel mortgage was not recorded until August 19, 1954. *On the date of its recordation Delcon was solvent; and the chattel mortgage was recorded more than four months preceding bankruptcy.*

The unpaid balance due petitioners prior to bankruptcy under their purchase price chattel mortgage was in default; and on December 27, 1954, (about two months prior to bankruptcy) petitioners repossessed such of the mortgaged equipment as they could locate. Delcon was not in possession of the mortgaged property *since December 1954.* The bankruptcy petition was filed against it on February 23, 1955.

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[1]The decision in *Moore* and its inapplicability to the present record is discussed *infra.*

During the period intervening between the execution of the chattel mortgage on June 1, 1954 and its recordation on August 19, 1954 (when Delcon was solvent), Delcon became indebted to simple trade creditors in the sum of $8,906.95. The major part of its trade indebtedness was incurred by Delcon after the recordation of the chattel mortgage on August 19, 1954.

On May 6, 1957, an order was made by the Referee declaring that the chattel mortgage was not void against the creditors of the bankrupt who came into existence *after the recordation of the chattel mortgage on August 19, 1954* (herein called late creditors).

On the petition for review filed by the trustee in bankruptcy under Section 39c of the Bankruptcy Act (11 U. S. C. Sec. 66), the order of the Referee was reversed; and on July 30, 1957, an order was made by the District Court declaring that the chattel mortgage was void in its entirety against all creditors of the bankrupt, including the late creditors (albeit, as noted *supra*, the chattel mortgage was recorded when the bankrupt was solvent and more than four months preceding bankruptcy and though under the California law noted *infra*, a chattel mortgage is valid against a mortgagor's subsequent creditors).

Relevant Proceedings in Delcon Bankruptcy Matter.

1. On February 23, 1955, an involuntary bankruptcy petition was filed against Delcon [R. p. 3].

2. On February 23, 1955, the bankruptcy matter was referred to a Referee in bankruptcy [R. p. 6].

3. On March 6, 1955, Delcon was adjudicated bankrupt by the Referee [R. p. 6].

4. On April 25, 1955, respondent was appointed by the Referee trustee of the estate of the bankrupt [R. p. 7].

5. On October 24, 1955, petitioners filed a verified secured claim for the unpaid purchase price due them under their chattel mortgage which was in default [R. p. 8].

6. On July 5, 1956, objections and a counterclaim were filed by the trustee in bankruptcy to petitioners' aforesaid secured claim alleging that the chattel mortgage was void against *all the creditors* of the bankrupt because of the delayed recordation of the chattel mortgage from June 1, 1954 until August 19, 1954 [R. p. 17].

7. On August 21, 1956, petitioners filed an amended answer to the trustee's counterclaim alleging that the Referee lacked summary jurisdiction to award an affirmative judgment against petitioners for the value of the mortgaged property repossessed by petitioners *prior to bankruptcy* under the terms of their purchase price mortgage [R. p. 23], based on Delcon's default.

8. The Referee's decision was filed February 8, 1957 [R. p. 53]; and his ensuing order was entered May 6, 1957 [R. p. 59].

9. The order of the District Judge reversing the Referee and ordering judgment against petitioners in the sum of $82,500.00 (less some minor credits) was entered July 30, 1957 [R. p. 63].

10. Notice of Appeal from the order of the District Court to the Court of Appeals for the Ninth Circuit was filed by petitioners on August 12, 1957 [R. p. 70].[2]

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[2]Under Rule 24 of the Bankruptcy Act (11 U. S. C. Sec. 47) jurisdiction is vested in Courts of Appeals to review affirm, revise, or reverse *interlocutory orders in controversies arising in proceedings in bankruptcy* (*e.g. In re Grenstreet, Inc.*, 209 F. 2d 660).

Opinions and Orders of the Courts Below.

1. The opinion and decision of the Referee are set forth at pages 32 to 53 inclusive of the printed Transcript of the Record.

2. The Order of the Referee declaring that petitioners' chattel mortgage *was valid* against the creditors of the bankrupt who came into existence after the recordation of the chattel mortgage on August 19, 1954 is set forth at page 59 of the printed Transcript of the Record.

3. The conclusions of law and order of the District Court declaring that the chattel mortgage was void in its entirety against all the creditors of the bankrupt under the decision in *Moore v. Bay, supra* (284 U. S. 4), are set forth at pages 67 to 70, inclusive, of the printed Transcript of the Record.

4. The opinion of the Court of Appeals for the Ninth Circuit is officially reported in 263 F. 2d, beginning at page 513; and a copy thereof is appended hereto as Appendix "A." A copy of the Judgment of the Court of Appeals is appended as Appendix "B"; and a copy of the order denying the petitioners' petition for rehearing is appended as Appendix "C."

Concise Statement of the Grounds on Which the Jurisdiction of This Court Is Grounded.

1. The judgment of the Court of Appeals (Appendix "B") affirming the order of the District Court was entered on January 16, 1959 [certified typewritten Record of the Proceedings in the Court of Appeals, at p. 87].

2. A petition for rehearing was filed by petitioners on February 13, 1959, within the time allowed therefor by the Rules of the Court of Appeals; and it was denied on April 17, 1959, without an opinion [certified Typewritten

Record of the Proceedings in the Court of Appeals, at p. 888].[3]

3. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1); Section 24(c) of the Bankruptcy Act (11 U. S. C. 47), and under Rule 19 of this Court.

Statutes Involved.

1. California Civil Code Section 2973 official (Deering's), at page 494, reads as follows:

> "Sec. 2973. (*Mortgages valid between parties and others with notice.*) Mortgages of personal property, other than that mentioned in section twenty-nine hundred and fifty-five, (not relevant here) and mortgages not made in conformity with the provisions of this article, *are nevertheless valid between the parties*, their heirs, legatees, and personal representatives, and persons who, before parting with value, have actual notice thereof." (Italics supplied.)

2. California Civil Code Section 2957 official (Deering's), at page 488 is lengthy and the pertinent part thereof is set forth in Appendix "D."

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[3]In their petition for rehearing (forwarded to this Court by the Clerk of the Court of Appeals) petitioners made an alternative request to have the judgment of the District Court modified and to have the case remanded to the District Court with directions to give petitioners the right to petition the District Court or the Referee for a subordination of the claims of the creditors of the bankrupt who came into existence after the recordation of the chattel mortgage to the claims of the petitioners and also to the claims of the creditors of the bankrupt who were in existence prior to the recordation of the chattel mortgage, pursuant to Section 57(K) of the Bankruptcy Act (11 U. S. C. Sec. 93) and in accord with the equitable doctrine of subordination expounded by this Court in *Pepper v. Litton*, 308 U. S. 295, 60 S. Ct. Rep. 238, and in other decisions cited *infra*. Such alternative request was not granted by the Court of Appeals in its order denying petitioners' petition for rehearing.

3. California Civil Code Section 3440 official (Deering's), at page 624, covers sales and mortgages *in fraud of creditors*. It does not deal with the legal effect of a delayed recordation of a chattel mortgage under the California law. (This section was the subject of the decision in the *Moore* decision *supra* (284 U. S. 4).) This section is too lengthy, and the pertinent part thereof is set forth in Appendix "D."

4. Section 60 of the Bankruptcy Act, as amended (11 U. S. C. Sec. 96), covers the subject of *preferences*; and it has no application on the present record since the instant chattel mortgage was recorded more than four months preceding bankruptcy, and furthermore the bankrupt was solvent on the date of its recordation.

5. Section 70(c) of the Bankruptcy Act, as amended (11 U. S. C. Sec. 110(c)) reads as follows:

> "c. The Trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

6. Section 70(e) of the Bankruptcy Act, as amended (11 U. S. C. Sec. 110(e)(1)) reads as follows:

> "e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under

this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

7. Section 57(k) of the Bankruptcy Act, as amended (11 U. S. C. Sec. 93), reads as follows:

"k. Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part *according to the equities of the case*, before but not after the estate has been closed." (Italics added.)

Questions Presented for Review.

1. Whether preference Section 60 of the Bankruptcy Act (11 U. S. C. Sec. 96) (relied on in part by the Court of Appeals) is applicable to the present record in light of the undisputed evidence that petitioners' chattel mortgage was recorded more than four months preceding bankruptcy (and when furthermore the bankrupt was solvent) and whether the application by the Court of Appeals of Section 60 of the Bankruptcy Act to the present record can be sustained.

2. Whether the decision of this Court in the *Moore* case, *supra* (284 U. S. 4), on which the District Court and the Court of Appeals heavily relied is analogous in principle to the present record in view of the fact that the Moore decision, and the decision of the Court of Appeals in the case at bar rest on divergent factual situations and involve the construction of dissimilar California statutes.

3. Whether the broad strokes and thrust in the *Moore* decision, (based upon a dissimilar factual situation and a dissimilar California statute) were narrowed and limited

by this Court in its subsequent decision in *Buffum v. Peter Barcelou Co.*, 289 U. S. 227, 53 S. Ct. 539, 77 L. Ed. 1140 in their application to the equities presented by this record.

4. Whether petitioners' unconscious delay in the recordation of their chattel mortgage *in absence of fraud* against creditors rendered their valid chattel mortgage void against creditors of the bankrupt who came into existence after the recordation of their chattel mortgage (which took place more than four months preceding bankruptcy) under Section 70(c) and 70(e) of the Bankruptcy Act in the light of the well settled and conceded California law that creditors coming into existence after the recordation of a chattel mortgage cannot attack its validity on the ground of its earlier delayed recordation.

5. Whether the late creditors of the bankrupt and the trustee in their behalf are estopped from attacking the validity of petitioners' chattel mortgage under the doctrine of estoppel *in pais* which courts of bankruptcy do consistently invoke in the exercise of their broad equitable powers.

6. Whether the Court of Appeals erred in failing to give any consideration to the all important equitable doctrine of estoppel *in pais* though it was urged by petitioners at their oral argument in the Court of Appeals and reurged in their petition for rehearing.

7. Whether the Court of Appeals erred in refusing to grant petitioners' alternative request in their petition for rehearing for a modification of its decision and for a remand of the case to the court below with directions to give petitioners the right to petition the District Court or the Referee for a subordination of the claims of the late creditors to those of the petitioners and of the other

creditors under the equitable rule buttressed by Section 57(k) of the Bankruptcy Act (11 U. S. C. Sec. 93).

8. Whether the repossession by the petitioners of the located chattel mortgaged property about two months prior to bankruptcy (which was authorized under the terms of the chattel mortgage) and the subsequent sale thereof by petitioners during bankruptcy to a bona fide purchaser at a fair price, was a conversion of the bankruptcy assets on which to predicate *an affirmative judgment* against petitioners in the sum of $82,500.00.

Statement of the Case.

The sketchy statement of the material facts touched upon slightly in the introduction to this petition are amplified and discussed comprehensively in the Memorandum Decision of the Referee [R. pp. 32-53]. The findings of facts of the Referee were adopted by the District Judge in his Findings of Facts [pp. 63-70]. The record presents solely questions of law involving the construction and interpretation of sections of the Bankruptcy Act in their application to the equities appearing in this record. Briefly summarized for the convenience of this Honorable Court, the facts material to a consideration of the questions presented for review are as follows:

Petitioners (referred to in the Memorandum Decision of the Referee as Millers and as the Miller Family) had extensive business, commercial and financial interests. In and prior to June 1954, they operated a valuable manufacturing business under the firm name of Miller Engineering Company [R. p. 33].

On June 1, 1954, petitioners sold their manufacturing business, including the physical assets located at their plant and the right to use their firm business name to

Delcon. In part payment Delcon executed and delivered to petitioners its promissory note for $189,000.00, payable in installments and which was secured by a chattel mortgage on the physical assets involved in the sale [R. p. 33]. The manufacturing business sold and transferred by petitioners to Delcon was a solid and solvent going concern. The down payment made by Delcon was in the minimal sum of $11,000.00; and as above noted the balance of the purchase price of $189,000.00 was secured by the instant chattel mortgage. The sale was a fair sale; and Delcon came into possession of a going business having a value of $200,000.00 with the minimal down payment of $11,000.00. There is no evidence in the record suggesting fraud against the creditors or a non-compliance with Section 3440 of the California Civil Code. The sale and transfer by petitioners of their going and solvent business to Delcon supplied Delcon with the means of carrying on a valuable trade. (*Cf. In re Mercury Engineering Co.*, 68 Fed. Supp. 376, 380 quoted from in Appendix G.)

Due to the dishonesty of an employee of petitioners who had been in their employ for about seven years and who had been delegated to promptly record the chattel mortgage, the recordation of the chattel mortgage was delayed from June 1, 1954 to August 19, 1954. On August 2, 1954 petitioners learned the first time that their trusted employee was an embezzler. (Opinion of Court of Appeals, App. A.)

The failure of their trusted employee to promptly record the chattel mortgage came to petitioners' attention the first time on August 19, 1954, whereupon the chattel mortgage was recorded by petitioners at once [R. p. 33].

On August 19, 1954, when the chattel mortgage was recorded Delcon was a going and solvent concern.

In December, 1954 Delcon was in default under the terms of the chattel mortgage; and on December 27, 1954 petitioners repossessed such of the mortgaged chattels as they could locate [R. p. 34]. The repossession by petitioners took place about two months prior to bankruptcy; and petitioners were authorized to take possession of the mortgaged chattels upon Delcon's default under the express provisions of the chattel mortgage [R. p. 34].

The repossessed chattel mortgaged property has remained in petitioners' possession since December 27, 1954. In March, 1955 (after the petition in bankruptcy was filed) petitioners sold the located chattel mortgaged property to a bona fide purchaser at a fair price in the sum of $82,500.00.

Between the execution of the chattel mortgage on June 1, 1954 and its recordation on August 19, 1954 (during which time Delcon was at all times a solid and solvent concern) credit was extended to Delcon by trade creditors in the sum of $8,906.95. The major portion of the trade indebtedness incurred by Delcon took place after the recordation of the chattel mortgage; *and the late creditors were charged with constructive notice and knowledge of petitioners' chattel mortgage superior lien.*

Delcon became insolvent in December, 1954 [R. p. 56] and the petition in bankruptcy against it was filed February 23, 1955.

The Referee declared in his Memorandum Decision that the trustee's position that the chattel mortgage was also void against the late creditors (who had constructive notice and knowledge of petitioners' superior chattel mortgage lien) shocked the conscience of the Referee. The Referee was of the view that the late creditors *were estopped in equity and good conscience from attacking*

the validity of the chattel mortgage, and that the Trustee in bankruptcy (who stood in their shoes) was likewise estopped from attacking the validity of the chattel mortgage for the benefit of such late creditors.

The order of the District Judge directed the Referee to enter an affirmative judgment against petitioners in the sum of $82,500.00 (less minor credits). It was affirmed by the Court of Appeals; and in its opinion the Court of Appeals made the unfavorable comment that the trustee sought "a windfall of $82,500.00."

THUS THE LATE CREDITORS (WHO HAD CONSTRUCTIVE NOTICE AND KNOWLEDGE OF PETITIONERS' CHATTEL MORTGAGE LIEN) WOULD BECOME UNJUSTLY ENRICHED TO THE EXTENT OF SAID WINDFALL OF $82,500.00, AS COMMENTED ON BY THE COURT OF APPEALS. NONETHELESS, PETITIONERS' EQUITIES WERE NOT RESPECTED BY THE DISTRICT COURT AND THE COURT OF APPEALS; AND THE EQUITABLE DOCTRINE PRECLUDING UNJUST ENRICHMENT WAS NOT GIVEN ANY CONSIDERATION BY THE DISTRICT COURT AND THE COURT OF APPEALS.

Jurisdiction of the Courts Below.

I. Jurisdiction in the District Court and in the Referee is vested under the provisions of the Bankruptcy Act, and is based on the records and proceedings in the Bankruptcy Matter of Delcon Corporation alluded to *supra*.

II. Jurisdiction in the Court of Appeals is vested under Section 24 of the Bankruptcy Act (11 U. S. C. Sec. 47) and (28 U. S. C. Sec. 1291).

III. The facts disclosing the basis of the jurisdiction of the District Court and of the Court of Appeals are stated in the Findings of Fact and Conclusions of Law of the Referee and of the District Court [R. pp. 53-59; pp. 63-70].

Reasons Relied on for Writ of Certiorari.

I.

The core of the principal question presented for review is whether under Sections 70(c), 70(e) and 60 of the Bankruptcy Act (11 U. S. C. A. Sec. 110, sub. c and sub. e(1); 11 U. S. C. A. Sec. 96) in light of the California law the trustee in bankruptcy was granted the right to attack the validity of petitioners' chattel mortgage (recorded more than four months preceding bankruptcy at which time the bankrupt was solvent) for the benefit of the creditors who came into existence subsequent to the recordation of petitioners' chattel mortgage. This all important question presents a *federal bankruptcy question*, which must be resolved by the decisions of the federal courts (*Moore v. Bay, supra*, 284 U. S. 4; 52 S. Ct. 3. 76 L. Ed. 133; *Cf. Baker v. Texas etc. Co.*, 79 S. Ct. Reporter No. 11 at page 665). The statement in the opinion of the Court of Appeals (263 F. 2d at page 516) that the infirmity of petitioners' chattel mortgage was not cured *against the trustee in Bankruptcy* by their repossession of the mortgaged property based on Delcon's default (which took place about two months prior to bankruptcy) under the California rule of law enunciated in *Noyes v. Bank of Italy*, 206 Cal. 266, needs correction. It is in conflict with the federal rule of law on this subject stated in Appendix "E."

II.

The decision in the *Moore* case, *supra* (the touchstone of the opinion of the Court of Appeals) is not analogous "in principle" to the case at bar in its application to the facts and telltale equities epitomized in the statement of the case *supra* and amplified in the memorandum decision of the Referee [R. pp. 32-53]. The *factual context* in the *Moore* case and the *factual context* in the case at bar are

governed by different principles and are based on the construction of dissimilar California statutes. The decision in the *Moore* case concerned a mortgage which under the California Civil Code Section 3440 then in force was *conclusively fraudulent and a nullity against all creditors of the mortgagor;* while the case at bar concerns a mortgage which under the California Civil Code Sections 2973 and 2957 is *valid against creditors who came into existence after the recordation of the chattel mortgage.* The opinion of the Court of Appeals failed to differentiate realistically the underlying basic facts in the *Moore* decision from the basic underlying facts and *equities* in the case at bar. It would seem that the Court of Appeals was of the view that the broad strokes in the *Moore* decision were applicable to the broad *equitable* issues presented in the case at bar. (Which latter equitable issues were not adjudicated in the *Moore* decision.)

III.

Futhermore, the opinion of the Court of Appeals cannot be reconciled in material aspects with the subsequent decision of this Court in *Buffum v. Peter Barcclous Co.*, 289 U. S. 227, 53 S. Ct. 539, wherein Mr. Justice Cardozo speaking for the Court shed a clarifying light on the precise holding of the *Moore* decision. At page 541 of the Sup. Ct. Rep. Mr. Justice Cardozo stated that a pledge perfected *more than four months preceding bankruptcy* was not subject to an attack by the trustee in bankruptcy *in absence of proof that the pledge was fraudulent in its inception against the bankrupt's creditors.*

IV.

The decision of the Court of Appeals cannot be reconciled with the decision of this Court in the leading case of *Pepper v. Litton,* 308 U. S. 295, 60 S. Ct. 238 (cited and

reaffirmed in numerous subsequent federal decisions and explicated by the United States District Court for the Eastern District of Michigan in *In re Cable-Link Corporation*, 135 Fed. Supp. 277, 287) wherein Mr. Justice Douglas speaking for this Court declared that a bankruptcy court in the exercise of its broad equity powers fortified by Sections 2 and 57(k) of the Bankruptcy Act has the undoubted power to allow, or to disallow, *or to subordinate general* claims of creditors to other claims "according to the equities of the case" and "in light of equitable considerations."

V.

The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Third Circuit *In re Consorto Construction Co.*, reported in 212 F. 2d 676, wherein the Court of Appeals for the Third Circuit decided that a chattel mortgage recorded *more than four months preceding bankruptcy* is not subject to an attack by the trustee in bankruptcy for the benefit of the creditors of the bankrupt who came into existence after the recordation of the chattel mortgage.

VI.

The failure by the Court of Appeals to invoke the doctrine of equitable estoppel *in pais* against the bankrupt's late creditors (who had constructive knowledge of petitioners' superior mortgage lien) and against the trustee (who stood in their shoes) which doctrine is consistently and uniformly invoked in equity is an unwarranted departure from the accepted and usual course of judicial proceedings in equity. The failure by the Court of Ap-

peals to grant the alternative request of petitioners in their petition for rehearing for subordination of the claims of the bankrupt's late creditors to the claims of the petitioners and to the claims of the bankrupt's creditors who were in existence prior to the recordation of the chattel mortgage is equally an unwarranted departure from the accepted and usual course of proceedings in equity; and it is also out of harmony with the letter and spirit of Sections 2 and 57(k) of the Bankruptcy Act.

VII.

The questions presented for review involve the construction and interpretation of important sections of the Bankruptcy Act in their application to the basic facts and equities presented by the record herein and in light of the applicable California statutes. As stated in the memorandum decision of the Referee the position of the trustee of bankruptcy was one "which literally shocked the conscience of the Referee;" such was not gainsaid by the District Court, and the inequitable position of the trustee in bankruptcy was commented on unfavorably in the opinion of the Court of Appeals as "a windfall of $82,500.00." The precise point whether a chattel mortgage *recorded more than four months preceding bankruptcy* is vulnerable to an attack by a trustee in bankruptcy for the benefit of creditors who came into existence after the recordation of a chattel mortgage has not been adjudicated in the *Moore* decision; and this important question of federal bankruptcy law has not been, but should be settled by this Court. A court of bankruptcy is a court of equity exercising equitable powers of broad sweep; and a bank-

ruptcy court may exert such powers in full vigor *with respect to the allowance, rejection and subordination of claims.* A court of bankruptcy is empowered to sift the circumstances surrounding any claim to see that injustice and unfairness is not done in the administration of the bankruptcy estate (*Cf. Rader v. Boyd*, 252 F. 2d 585, at p. 586). These equitable principles were not considered by the Court of Appeals in the case at bar, and the tell-tale equities of the petitioners were not respected Sections 70(c), 70(e) and 60 of the Bankruptcy Act (on which the opinion of the Court of Appeals was anchored) must not be read in isolation, but must be read in conjunction with the other and related sections of the Bankruptcy Act, and Section 57(k) of the Bankruptcy Act; they must be also read in light of the equitable philosophy embedded in the Bankruptcy Act. It is inconceivable that it was the intent or policy of Congress to dilute or to curb the equity powers of a bankruptcy court and to delete Section 57(k) of the Bankruptcy Act. Under the opinion of the Court of Appeals the late creditors would become unjustly enriched; and under the California law such creditors are not in the same category or class with petitioners.

Summary of Argument.

This Summary of the Argument is presented in amplification of the reasons relied on for the allowance of the writ of certiorari *supra*.

I.

Under the California Law (Which Governs the Substantive Property Rights of a Mortgagee) Creditors of a Mortgagor Coming Into Existence After the Recordation of a Chattel Mortgage Cannot Attack Its Validity on the Basis of Its Prior Delayed Recordation.

This substantive California law was conceded by the District Judge [R. p. 57, Conclusions of Law II and III]; and same finds support in numerous California decisions some of which were cited by the Court of Appeals for the Ninth Circuit in:

Swift v. Higgins, 72 F. 2d 791;

Bank of California v. Sampsell, 114 F. 2d 211.

This California *Substantive* law was not affected by the Bankruptcy Act; instead it was adopted in Section 60 and Section 57 (g) 70 (e) of the Bankruptcy Act.

II.

The Opinion of the Court of Appeals Is Premised on an Impermissible Interpretation of the Precise and Narrow Holding of This Court in the Moore Decision. The Moore Decision Attacked the Validity of a Chattel Mortgage Which Was Conclusively Fraudulent and a Nullity in Its Inception Under the California Civil Code Section 3440 Then in Force.

In view of the apparent breadth of the views of the Court of Appeals on the decision in the *Moore* case under the doctrine of *stare decisis* (which doctrine petitioners pause to observe is not inflexible but is *adaptable and adjustable* to changed and fresher concepts of justice and fairness), it may promote a correct analysis of the *Moore* decision to emphasize at the outset what it did not involve.

The *Moore* decision did not involve a chattel mortgage which *was valid in its inception* under the California law; nor did it involve a chattel mortgage which was recorded more than four months preceding bankruptcy and when the mortgagor was solvent; nor did it attack the validity of a chattel mortgage on the ground of its late recordation under California Civil Code Section 2957; nor did it discuss the problem whether the trustee in bankruptcy could attack the validity of a chattel mortgage for the benefit of creditors who came into existence after the recordation of a valid chattel mortgage *more than four months preceding bankruptcy* and during the solvency of the mortgagor; nor did it discuss the application of the equitable doctrine of estoppel *in pais*, against subsequent creditors; nor did it discuss the application of the equitable doctrine of subordination fortified by Sections 2 and 57(k) of the Bankruptcy Act; nor did it discuss the application of the equitable doctrine precluding unjust enrichment by creditors who had notice of an existing superior chattel mort-

gage lien and who extended credit to the bankrupt in their awareness of the existing superior chattel mortgage lien; nor did it involve a shocking and unconscionable course of conduct such as depicted by the Referee in his memorandum decision.

The critical facts on which the *Moore* decision was premised are stated fully in the opinion of the Court of Appeals for the Ninth Circuit *In re Sassard Kimbal, Inc.*, reported in 45 F. 2d 449. The mortgage therein attacked *was conclusively fraudulent in its inception and was a nullity under California Civil Code Section 3440 then in* force (see App. D). No notice of intention to take a mortgage on the property of the mortgagor (the bankrupt) was recorded or filed *prior to the execution of the chattel mortgage;* and the chattel mortgage was therefore *conclusively fraudulent* against the existing creditors under the express and mandatory provisions of Section 3440 of the California Civil Code. The chattel mortgage involved in the *Moore* decision was *a nullity under the California decisions* (*Cf. Mitchell v. Setzler*, 84 Cal. App. 2d 716, at page 720) *under which the mortgagee did not acquire any rights in the mortgaged property.* (*Cf. Mallaquras v. Novo*, 59 Cal. App. 2d 225, at page 231.) Furthermore the opinion in the *Moore* decision does not indicate *whether* the notice of intention was recorded either within or more than four months before bankruptcy.

Petitioners respectfully submit that the statement in the opinion of the Court of Appeals (263 F. 2d at page 515) that the *Moore* case and this case cannot be distinguished "in principle" is erroneous. One has to look hard and far to find any semblance of analogy of the factual context in the *Moore* decision to the equitable factual context in the present record.

III.

A Chattel Mortgage Recorded More Than Four Months Preceding Bankruptcy Is Not Vulnerable to an Attack by a Trustee in Bankruptcy for the Benefit of Creditors Who Came Into Existence After the Recordation of a Chattel Mortgage in Absence of Proof That the Chattel Mortgage Was Fraudulent in Its Inception Against Creditors.

Buffum v. Barceloux Co., supra, (289 U. S. 227) was a plenary action instituted by a trustee in bankruptcy to declare null and void a pledge executed by the bankrupt followed by a secret sale thereof for much less than its fair value. The evidence was that the pledge was fraudulent *in its inception* and a chain in a general plan conceived by the bankrupt to defraud the bankrupt's creditors. The action was brought under Section 70(e) of the Bankruptcy Act (11 U. S. Code, par. 110). The court sustained the findings of the District Judge that the pledge was fraudulent *in its inception. On that ground* the decree of the District Court for the trustee was affirmed, and in support thereof the *Moore* decision was cited. At page 232 (289 U. S.) the court stated that the evidence sustained the findings of the District Court that the pledge was made to defraud the creditors, but *that if no fraud had been intended,* "the pledge would be proof against attack, *for it was made* more than four months before the bankruptcy petition." (Italics added.)

In *In re Consorto Construction Co.,* 212 F. 2d 676, the Court of Appeals for the Third Circuit decided that a chattel mortgage recorded more than four months before

bankruptcy is not vulnerable to an attack by the trustee in bankruptcy for the benefit of the creditors who came into existence after the recordation of the mortgage either under Section 70(c) or 70(e) of the Bankruptcy Act. This decision makes a realistic and common sense approach to the precise problem presented by the record in the case at bar; and for the convenience of the Court we quote from it in Appendix "F."

The decision of the Court of Appeals for the Eighth Circuit in *Mercantile Trust Co. v. Kahn*, 203 F. 2d 449 (relied on by the Court of Appeals in its opinion) did not involve the rights of subsequent creditors under a mortgage *recorded more than four months before* bankruptcy.

The realistic and logical approach made by the Court of Appeals for the Third Circuit in *Consorte, supra*, (see App. F) was not made by the Court of Appeals for the Second Circuit in *Constance v. Harvey* reported in 215 F. 2d at page 571; and the opinion in the *Constance* case *supra* indicates an apparent conflict between the decisions of the Courts of Appeal for the Third and the Second Circuits. Moreover, the opinion of the Second Circuit in the *Constance* case *supra* was predicated on the court's interpretation of the policy established by the decisions of the State of New York bearing on the legal effect of Paragraph 230 of the New York Lien Law (see page 575 of the decision).

The decision in *Constance, supra*, was not followed by the New Jersey United States District Court in *Matter*

of American Textile Printers Co., 152 Fed. Supp. 901, on the ground that the New York State policy was not comparable with the policy adopted by the State of New Jersey (page 901 of the decision).

The opinion of the Referee *In re Pierro*, 159 Fed. Supp. 497 states in footnote 2 at page 498 that the decision in *Constance, supra*, has been widely criticized and not followed in other districts and cities in support thereof the following: Seligson, Annual Survey of American Law, Bankruptcy, 30 N. Y. U. L. Rev. 558 (1955); Seligson, Creditors' Rights, 32 N. Y. U. R. Rev. 708 (1957); Marsh, Constance v. Harvey—The "Strong-Arm Clause" Evaluated, 43 Calif. L. Rev. 65 (1955); Levin and Weintraub, The Strong-Arm Clause Strikes The Belated Chattel Mortgage, 25 Fordham Law Review 261. In said footnote the Court further stated that with all due respect to the Second Circuit, this Court concurs with this criticism and therefore follows the traditional interpretation of the rights of a trustee under Section 70, sub. e.

The decisions cited in 4 Collier in Bankruptcy Par. 70.95 at pages 1533-1536 to the effect that the *Moore* decision is operative in cases involving a delayed recordation of a chattel mortgage do not deal with mortgages *recorded more than four months before bankruptcy*; nor do they discuss the common sense rule announced by the Third Circuit in the *Cosorto* case *supra*; nor do they make reference to the *Buffum* decision *supra* (289 U. S. 227); nor do they comment on the application of Section 57(k) of the Bankruptcy Act.

IV.

Bankrupt's Subsequent Creditors Were Charged With Notice and Knowledge of Petitioners' Superior Mortgage Lien, Which Has Been Perfected More Than Four Months Before Bankruptcy; and They Were Aware of the Existence of Petitioners' Superior Mortgage Lien When They Extended Credit to the Bankrupt. In Equity and Good Conscience Their Claims Must Be Subordinated to Petitioners' Mortgage Lien.

In *Pepper v. Litton*, 308 U. S. 295, 60 S. Ct. 238, Mr. Justice Douglas, speaking for the court declared:

> "The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked to the end that fraud will not prevail, *that substance will not give way to form, that technical considerations will not prevent substantial justice from being done.* By reason of the express provisions of §2 these equitable powers are to be exercised on the allowance of claims, a conclusion which is fortified by §57, sub. k, 11 U. S. C. A. §93 sub. k, 12. For certainly if, as provided in the latter section, a claim which has been allowed may be later 'rejected in whole or in part, according to the *equities of the case*,' disallowance or *subordination in light of equitable considerations* may originally be made." (Emphasis ours.)

In *Bank of America v. Erickson*, 117 F. 2d 896, the Court of Appeals for the Ninth Circuit declared at page 898:

> "The bankruptcy court has undoubted power to subordinate a general claim to other claims in the

same category *where for any reason, legal or equitable, it ought to be subordinated.*"[4] (Italics supplied.)

In *Kader v. Boyd*, 252 F. 2d 585, the Court said at page 586:

> "A court of bankruptcy is a court of equity, exercising equitable powers of broad sweep. And, within the statutory scheme, the Court may exert such powers in full vigor with respect *to the allowance, rejection or subordination of claims.* It is empowered to 'sift the circumstances surrounding any claim *to see that injustice and unfairness is not done in the administration of the bankruptcy estate.*'". (Italics added.)

The equitable rule of subordination enunciated in the *Pepper* decision *supra* was made explicit in *In re Cable-Link Corporation*, 135 Fed. Supp. 277. At page 281 the Court said:

> "It is true that in the Pepper case the court exercised its equitable power to defeat a fraudulent scheme, but it must be kept in mind that equitable estoppel can be established without actual fraud or a fraudulent intent. (Citing cases.)
>
> "A court of bankruptcy, in the exercise of its broad equitable powers, *may apply the equitable doctrine of estoppel in pais.* (Citing cases.)

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[4]As noted *supra* under the California decisions creditors coming into existence after the recordation of a chattel mortgage are not in the same category with a mortgagee.

V.

The Equitable Doctrine Precluding Unjust Enrichment Govern the Inequities of the Trustee's Petition Comprehensively Discussed in the Decision of the Referee.

The doctrine precluding unjust enrichment has been settled in the recent California decisions cited in *Bensinger v. Davidson,* 147 F. Supp. 240 at 247. As stated by Judge Carter in the last cited case at page 247:

> "We think the California cases rest on the principle of 'unjust enrichment' and the policy of the law against forfeitures. This language runs through the California cases. We therefore approach the problem on equitable principles. Has Bensinger been unjustly enriched, and if so, by how much?"

In Restatement of the law on Restitution, par. 160(c) at page 642, it is stated:

> "c. UNJUST ENRICHMENT. A constructive trust is imposed upon a person in order to prevent his unjust enrichment."

In Restatement of the law on Security, par. 59(c) at page 160, it is stated:

> "c. EQUITABLE LIEN. The term 'lien,' in its broadest sense includes equitable liens, which do not depend upon possession. Equitable lien is defined in the Restatement of Restitution, §161, as follows: 'Where property of one person can by a proceeding in equity be reached by another as security for a claim on the ground that otherwise the former would be unjustly enriched, an equitable lien arises.' "

Pomeroy in Equity Jurisprudence, in interpreting the maxim that he who seeks equity must do equity said in Section 385:

> "That whatever be the nature of the controversy between two definite parties, and whatever be the nature of the remedy demanded, the Court will not confer its equitable relief upon the party seeking its interposition and aid, unless he acknowledge and concede, or will admit and provide for, all the equitable rights, claims and demands justly belonging to the adverse party and growing out of or necessarily involved in the subject matter of the controversy."

The equitable constructive trust doctrine was invoked *against the trustee in bankruptcy* in the decision rendered by Judge Oliver J. Carter of the United States District Court for the Northern District of California, on April 1, 1959, *In re Newcomb Interests, Inc.*, reported in Volume 171, No. 5, of Federal Supplement, at page 704. It is petitioner's contention that the equities against the trustee in bankruptcy involved in the *Newcomb* bankruptcy case are parallel with the petitioner's equities on the present record in the case at hand. (See Appendix "G".) In the *Newcomb* case a written sales contract was made by owners of a hotel as sellers and the bankrupt as purchaser providing for a transfer by the sellers to the bankrupt of the sellers' liquor license, and providing further for a re-transfer thereof by the bankrupt to the seller upon the bankrupt's default in the payment of the purchase price which was secured by a recorded chattel mortgage. The Court held that the agreement obligating the bankrupt on his default to re-transfer the liquor license to the sellers imposed on the bankrupt a constructive *trust* lien under the California decisions, and such lien was binding upon and operative against the trustee in bankruptcy (p. 707 of the decision).

VI.

Petitioners' Repossession of the Located Mortgage Property Was Lawful Under the Federal Rule Stated in Appendix E. Their Repossession Did Not Give Rise to an Action in Conversion; and the Affirmative Judgment Against Petitioners in the Sum of $82,500.00 Cannot Be Sustained.

Passing over the point that the court below lacked summary jurisdiction to render an affirmative judgment (which point was raised by petitioners in the District Court as pointed out earlier in this petition), under the California law petitioners have acquired a property interest in the mortgaged chattels on the date of the execution of the chattel mortgage on June 1, 1954 (eight months before bankruptcy) (*Estate of McLaughlin*, 97 Cal. App. 484, 485; *Bank of California v. McCoy*, 23 Cal. App. 2d 192, 195). They also had a property interest therein as prior owners thereof. Petitioners were therefore legally entitled to take possession of the chattel mortgage property upon Delcon's default under the Federal rule stated in Appendix "E;" the challenged affirmative judgment deprived petitioners of their property interest in the mortgaged chattels in violation of the substantive due process of law ingrained in the Fifth Amendment to the United States Constitution. Petitioners had also the legal right to take possession *of their own property* in light of the equities discussed in the decision of the Referee and in Appendix "G".

Conclusion.

We wish to preface this conclusion with the restatement of the well settled rule that court opinions do not rest on abstract principles having no relation to the factual context; and court opinions must be read in the light of

the precise legal and equitable problems before the Court in their application to the facts and equities therein involved.

We believe the answer to the erroneous views of the Court of Appeals is supplied by the learned and experienced Referee in his scholarly decision, wherein the underlying equity philosophy of the Bankruptcy law is comprehensively analyzed, and the inapplicability of the *Moore* decision to the problems presented by the record is lucidly pointed out. We submit that the Referee's decision is sound; that it comports with the concept of justice and fairness, the bedrock on which the equity structure of the bankruptcy law was erected by Congress; that the decision of the Referee merits consideration by this Honorable Court, and it should be adopted by this Court.

Clearly, the reliance by the Court of Appeals on Section 60 of the Bankruptcy Act (preference section) was misplaced, since petitioners' chattel mortgage was recorded more than four months before bankruptcy, and in addition thereto, the bankrupt was solvent on the date of its recordation. *Buffum supra* (289 U. S. 227); and for the same reason the reliance by the District Court on Section 57(g) of the Bankruptcy Act [R. p. 58] was equally misplaced.

We respectfully contend that the opinion of the Court of Appeals did not make a realistic appraisal of the precise and narrow problem adjudicated in the *Moore* decision, and it stretched its construction and was unrealistic in its application to the problem and equities posed by the present record.

The opinion of the Court of Appeals spreads a chilling cloud over and around the equity powers of the Bankruptcy Court, and conducts an inquest over its equity

powers governing allowance, or disallowance, or subordination of claims according to the equities of the parties and in light of the equity considerations emphasized in the decision of the Referee and in the decisions cited herein.

We do not believe that it was the intent of the *Moore* decision to abrogate and nullify the equity doctrine of estoppel *in pais against creditors who had knowledge of petitioners' superior mortgage lien, or to abrogate and nullify the equity doctrine precluding unjust enrichment of such creditors.*

Our research failed to find any decision of this court sanctioning an abdication by a bankruptcy court of these well settled and accepted equity principles which deny to a trustee in bankruptcy the right to attack the validity of a valid chattel mortgage *recorded more than four months before bankruptcy for the benefit of the subsequent creditors of the mortgagor who, under the applicable California law, are estopped from attacking its validity on the ground of its prior delayed recordation.*

We respectfully pray that this Honorable Court assume jurisdiction to settle these all important bankruptcy questions in their application to the present record; and to resolve the existing conflicts between the Courts of Appeals pointed out in this petition; that this Court issue a writ of certiorari to review the adverse judgment of and decision of the Court of Appeals and to reinstate the judgment of the Referee.

Respectfully submitted,

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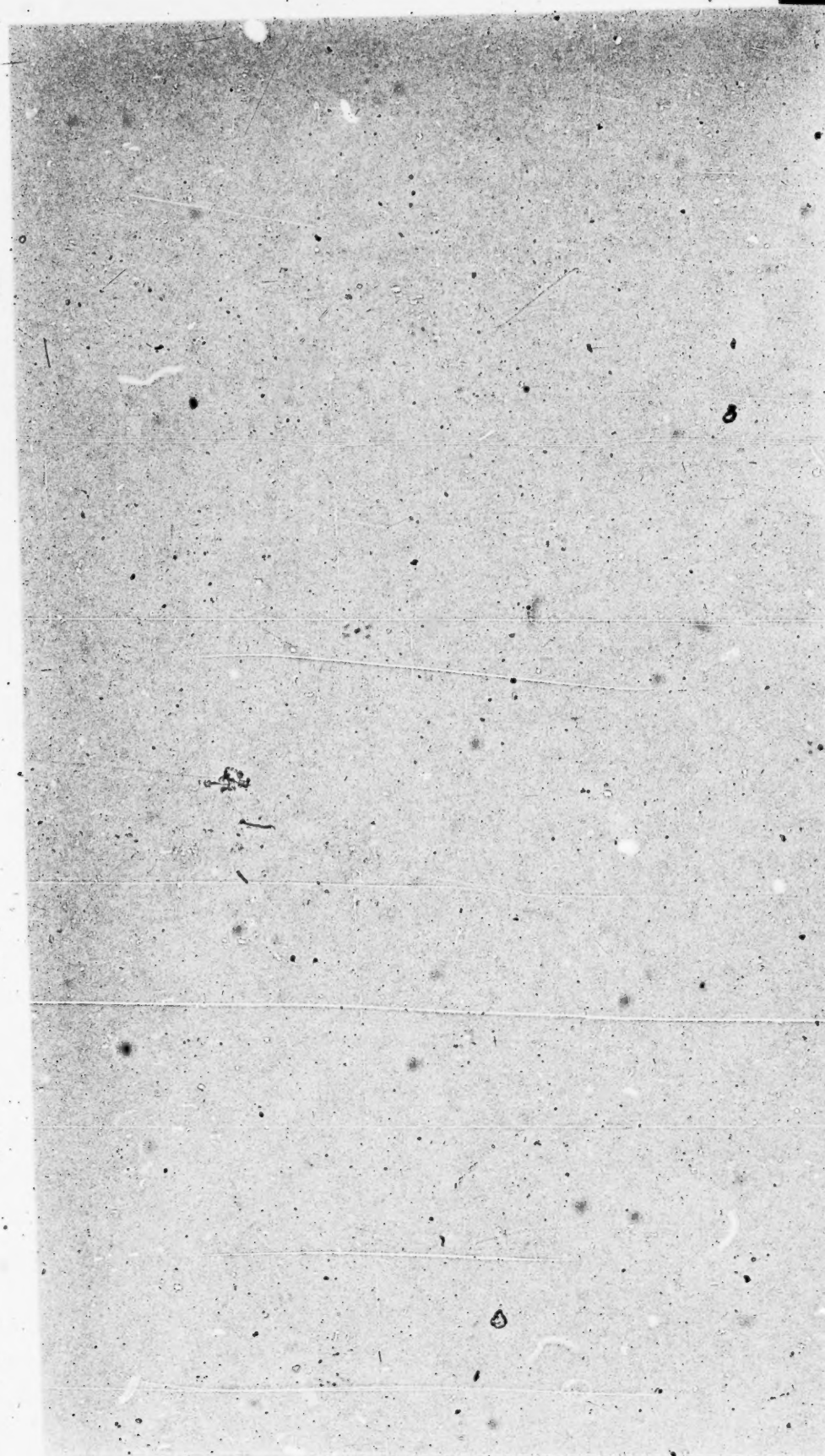

APPENDIX "A."

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Elias Miller, Paul Miller, Anna Miller and Helen Miller, and Elias Miller and Paul Miller, as executors of the estate of George Miller, deceased, Appellants, vs. Irving Sulmeyer, trustee in bankruptcy of the estate of Delcon Corporation, bankrupt, Appellee. No. 15,781.

Jan. 16, 1959.

Appeal from the United States District Court for the Southern District of California; Central Division.

Before: STEPHENS, CHAMBERS and BARNES, Circuit Judges.

CHAMBERS, Circuit Judge:

The Millers sold a business in June, 1954, to the now bankrupt Delcon Corporation. They took back from Delcon a purchase money mortgage on chattels transferred to Delcon. There was a 79 day delay in recording of the chattel mortgage. This failure of the Millers to record was due to the negligence of a "trusted employee" who was apparently too busy with his defalcations of his employers' cash to attend to routine business.[1]

Eventually in December, 1954, under the terms of the mortgage the Millers repossessed the chattels and resold

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[1]California Civil Code Section 2957 reads as follows:

"A mortgage of personal property . . . is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless

. . . . . .

"4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed . . ."

the property in March, 1955, for $82,500. All agree this was a fair price.[2]

Delcon was insolvent at the time of the repossession, but solvent at the time of execution of the mortgage. The Millers filed a claim with trustee Sulmeyer for $141,742.50. This was mainly the balance due on the original note and mortgage which were in the amount of $189,000. Objections were made to the whole claim by the trustee. He asserted that by superimposing the bankruptcy act on the California state law the trustee had a right first to recover the proceeds of the sale of the chattels after which the claim could be allowed.

At the time of hearing before the referee there were on file claims for $8,906.95 (including some $7,863.64 due to the ubiquitous director of internal revenue) which originated prior to the filing date of August 19, 1954, for the chattel mortgage, but probably after the date of the mortgage. All other creditors apparently postdated the recording date.

The referee ruled that the Millers must repay the sum of $8,906.95, at which time they could have their claim for $141,742.50 allowed along with a supplemental claim in the amount of $8,906.95, both items to be general and unsecured claims. On review, the district court directed the referee to enter judgment against the Millers for $82,500 (less certain small credits). Upon payment thereof the Millers were to have their claim of $141,742.50 allowed as well as a supplemental claim for $82,500, all as unsecured claims. From this heavy blow, the Millers have appealed.

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[2]The petition of three creditors for an adjudication of involuntary bankruptcy of Delcon was filed on February 23, 1955. The adjudication was made by the referee on March 16, 1955.

And, so the question here is whether the trustee is entitled to this windfall of $82,500. If so, the result is that the Millers originally sold their property without getting any security. This court is of the opinion, try as it may to reach a different result, that the case of Moore v. Bay, 284 U. S. 4 (reversing In re Sassard & Kimball, 9 Cir., 45 F. 2d 449) controls and that the district court must be affirmed. Cf. Mercantile Trust Co. v. Kahn, 8 Cir., 203 F. 2d 449.

All agree that but for the interposition of the bankruptcy adjudication the Miller repossession and sale under California state law would be impeccable as against creditors of Delcon becoming such after August 19, 1954. It would seem equally clear that creditors whose debts originated in the delayed period of 79 days under California law might have attacked the mortgage—here to the extent of $8,906.95.

The following extracts from the bankruptcy act should be quoted:

11 U. S. C. §110(c) (Bankruptcy Act, §70(c).):

"The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, *whether or not such a creditor actually exists.*" (Emphasis supplied.)

11 U. S. C. §110(e)(1), (Bankruptcy Act, §70(e)(1):

"A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent

as against or *voidable* for any other reason *by any creditor* of the debtor, having a claim provable under this Act, *shall be null and void as against the trustee of such debtor.*" (Emphasis supplied.)

11 U. S. C. §96, (Bankruptcy Act, §60):

"(a)(1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

* * *

"(b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent."

It is true, as the Millers say, the infirmity in the California chattel mortgage in Moore v. Bay, *supra*, was slightly different. There it was failure to give the required statutory notice of intention to give a chattel mortgage. However, this court finds itself unable to distinguish that case and the Millers' case in principle.

While the members of this court might belong to the legislative school that would vote to require trustees to take over rights as the state left them, still it is well settled that bankruptcy statutes can do more. And it would appear the sections above quoted do pick up the California state law, use it as a springboard and go beyond it. Sec-

tion 70(e)(1) says if any creditor could knock out the "transfer" as to him, the transfer is void as to the trustee. Section 70(c) only requires a hypothetical creditor not a real one. And Section 60 does nothing to weaken the other two sections. It buttresses them.

The Millers attack the constitutionality of the sections as here interpreted to take away from them their $82,500. Those things are constitutional which the Supreme Court says are constitutional. The point is answered by that court in Wright v. Union Central Ins. Co., 304 U. S. 502.

The Millers belatedly made three other points. The first is that the delay was excusable. The fact that the employee was simultaneously embezzling other assets is no excuse. None other is suggested.[3] Second, it is argued that purchase money mortgages are exempt. The language of §2957 of the California Civil Code is all inclusive. The general rule elsewhere is against the Millers and no persuasive California authority is cited for the idea.[4] Thirdly, it is suggested that the repossession before bankruptcy cured the infirmities. This might be true in

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[3]While California does not require instantaneous recording, it does require that it be recorded as soon as practicable. And there is no California case which has upheld anything like a 79 day delay. See Wolpert v. Gripton, 213 Cal. 474, 2 P. 2d 767, and Williams v. Belling, 76 Cal. App. 610, 245 P. 455.

[4]The court does not consider the situation in In re Mercury Engineering, (S. D. Cal.) 68 F. Supp. 376, to be parallel. There the district court determined that according to California law it was not necessary in the case of a purchase money mortgage to comply at all with §3440 of the California Civil Code requiring the filing of advance notice of intention to give a chattel mortgage. Therefore, the bankruptcy sections do not come into operation. Surely California would not hold that a purchase money chattel mortgage need never be recorded. The reason is that a large amount of apparently unencumbered assets permits a false appearance of economic health if they are in fact encumbered. In such circumstances general creditors would think at least that there was a substantial fund for all general creditors.

some states, but the California rule appears to be against the Millers on the point. Noyes v. Bank of Italy, 206 Cal. 266, 274 P. 68.

While it may be said that the state laws imposing penalties for failure to record instruments are drastic enough without superimposing additional federal sanctions, still the sanctions were written by the Congress and this court must give effect to them, harsh as they seem to be here.

While the brief for appellants is an able one, this court just cannot get away from the proposition that if the mortgage was subject to attack under California law by any creditor or even by the creditor who wasn't, but who might have been, then the bankruptcy act and Moore v. Bay, *supra*, permit the trustee to demolish the creditor's security although partially valid under state law (or even wholly valid in some circumstances because of the absence in fact of a certain type of creditor).

The order subject to this appeal is affirmed.

(Endorsed:) Opinion. Filed Jan. 16, 1959.

Paul P. O'Brien, Clerk.

APPENDIX "B."

Judgment.

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

(ENDORSED) Judgment

Filed and entered: January 16, 1959

PAUL P. O'BRIEN, Clerk

APPENDIX "C."

Order Denying Petition for Rehearing.

On consideration thereof, and by direction of the Court, IT IS ORDERED that the petition of Appellants, filed February 13, 1959, and within time allowed therefor by rule of court for a rehearing of the above cause be, and hereby is denied.

APPENDIX "D."

1. California Civil Code Section 2957 (Deering's) at page 488, reads in pertinent part that a mortgage of personal property is void as against creditors of the mortgagor and subsequent purchasers and creditors and encumbrancers of the property in good faith and for value

2. California Civil Code Section 3440 (Deering's) at page 624, in force prior to 1953, provided in pertinent part that *unless a notice of an intended chattel mortgage was recorded at least 7 days prior to its execution or filing, the chattel mortgage will be conclusively presumed to be fraudulent and void as against creditors.* This section was in force when the *Moore* decision, *supra,* was rendered by this Court (284 U. S. 4). In 1953 this section was amended by adding thereto Section 3440.1 providing, *inter alia* for a notice of at least 10 days (instead of seven days) prior to the execution of the chattel mortgage. (Italics supplied.)

APPENDIX "E."

In his unreported opinion in the Bankruptcy matter pending in the United States District Court, Southern District of California, Central Division, No. 18334-BH, United States District Judge Mathes declared the applicable federal rule of law to be as follows:

> "There is no dispute but that the chattel mortgages and conditional sales contracts were valid and were entered into more than four months before bankruptcy. If in default there can be no question, then, of defendant's right to foreclose its security according to the terms of the contracts and mortgages *up to and within four months of the date of bankruptcy*. (See the discussion and authorities cited in MacLachlan on Bankruptcy Section 216 (1956); and see also the discussion in *Straton v. New*, 283 U. S. 318, 325-326 (1931).) (Italics added.)
>
> "In other words, since the contracts and mortgages were executed, were admittedly valid and were executed more than four months prior to bankruptcy, the security could be foreclosed *within the four-month period* just the same as it could be prior to the commencement of the four-month period." (Italics added.)

In 4 Remington on Bankruptcy at page 441, Paragraph 1728.3, it is stated:

"A chattel mortgage usually gives the mortgagee the right to take possession of the property mortgaged and to foreclose in case of default, and the chattel mortgage statutes in many states make possession of the property by the mortgagee equivalent to recording of the mortgage, either directly, or by providing that the mortgage shall not be effective as against creditors unless accompanied by change of possession, etc. The mortgagee, by coming lawfully into possession of the property *before filing of the bankruptcy petition,* can accordingly, under such provisions, perfect his rights as against the rights of the trustee in bankruptcy of the mortgagor under §70(c) of the Act." (Italics supplied.)

APPENDIX "F."

Excerpt From Opinion in In re Consorto Construction Co., 212 F. 2d 676, at 679.

"There are other statutes, notably those of California and New Jersey, which state no time for recording yet are construed to require immediate recording in order for the instrument to be valid even though they do not, like the Missouri statute, relate the lien back to the execution date. (Citing California and New Jersey decisions.) Courts which adopt this construction seem to be persuaded that there is a danger of imposition on unsecured creditors of the mortgagor if a delayed filing is held to create a lien even from the time of recordation. *But the same result can be obtained merely by re-executing the old unrecorded mortgage and recording this 'new' instrument at once. It seems worthless formalism to require such re-execution of the old instrument as a basis for effective recordation.* (Italics added.) We think that a chattel mortgage while unrecorded can be fairly recognized as having a potential like a pledge, originally ineffective for failure to deliver possession. In the latter situation, a subsequent delivery will generally perfect the pledge except as to bona fide purchasers or creditors who have acquired liens prior thereto. Brown, Personal Property, Sec. 128. Under the 1945 Pennsylvania Chattel Mortgage Act, we believe it to be the proper construction that a tardy recording will perfect the lien of a chattel mortgagee as of the date of recordation.

"Here the chattel mortgagee obtained a lien August 3, the date of recording. Anyone subsequently obtaining an interest in or claim against the property was subordinated to that lien. Under Section 70, sub. c the trustee's position is that of such a subsequent lienor, 'holding a lien

* * * by legal or equitable proceedings' as of the date of bankruptcy, a time more than four months after Equity (the mortgagee) perfected its mortgage lien.

"The trustee is in no better position under Section 70, sub. e which provides:

"A(n) * * * obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

Under this subdivision the trustee is subrogated to the rights *of existing creditors* as to whom the obligations of the bankrupt are voidable. (Italics added.)

APPENDIX "G."

Excerpts From In re Mercury Engineering Co., 68 Fed. Supp. 376:

At page 380:

"The claimant here, Arthur E. Barili, for a long time prior to June 26, 1943, owned and operated a machine shop at 722 North Broadway, Los Angeles, California. On that day he sold it as a going concern to Charles B. Taylor, * * * for a total sum of $16,000. Barili received $5,000 in cash and the balance was to be evidenced by a promissory note in the sum of $11,000 secured by a chattel mortgage upon the business, machinery and equipment sold. The chattel mortgage is undated, but was acknowledged on June 30th, and delivered to Barili. * * * During the week, Barili remained at the place of business. The following Monday, July 26th, the chattel mortgage was recorded."

* * * * * * * *

At page 378:

"* * * the chattel mortgage is first challenged because of failure to comply with Section 3440 of the California Civil Code * * *"

At page 379:

* * * * * * * *

"We need not go into a detailed discussion of this section. It has its duplicate in almost every state in the Union, including the State of New York. California Courts do not seem to have been called upon to determine whether its provisions apply *to a purchase price chattel mortgage*. But the referee rightly

concluded that it did not so apply upon no less an authority than the Circuit Court of Appeals for the Second Circuit whose opinions upon a matter of this character interpreting a New York statute of identical import with ours command not only respect, but require following when no contrary ruling in our own Circuit appears. *This is especially the case when the decision accords with the very philosophy which lies behind the enactment. Its object is to protect the creditors against a surreptitious sale or incumbrance of the chief assets or equipment of a trader. But when the incumbrance is to secure the moneys which represented the price of these assets, the reason for the requirement disappears. For to hold that the seller who, instead of receiving cash acquires a mortgage on property which he transfers to a buyer, must subordinate his rights to this buyer's other creditors, is to penalize him for supplying to the buyer the very means of carrying on a trade.* It would mean to subsidize the existing creditor who may have extended credit on the basis of ownership of other assets at the expense of the man who furnishes the stock in trade or equipment to carry on a business. When we require notice before sale of stock in trade, we do so in order that the basis on which the prior credit had been secured be not dissipated without notice. But when the basis did not exist, but came into being through the very sale and incumbrance, the very foundation for the requirement is gone. * * *" (Italics supplied.)

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IN THE

Supreme Court of the United States

October Term, 1958
No.

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of GEORGE MILLER, Deceased,
Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF OF RESPONDENT IN OPPOSITION.

Opinions Below.

The opinion of the Referee in Bankruptcy is unreported, but appears at pages 32-53 of the Record.[1] The District Court for the Southern District of California rendered no formal opinion; its findings of fact, conclusions of law and order are unreported, but appears at pages 63-70 of the Record. The opinion of the Court of Appeals for the Ninth Circuit is reported at 263 F. 2d 513.

Jurisdiction.

The judgment of the Court of Appeals was entered on January 16, 1959. A petition for rehearing was denied

[1]All citations to the "Record" refer to the Transcript of Record in the Court of Appeals.

on April 17, 1959. The petition for certiorari was filed on June 8, 1959. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254(1) and Section 24c of the Bankruptcy Act, 11 U. S. C., Sec. 47c.

Statutes Involved.

Bankruptcy Act, Section 70e(1), 11 U. S. C., Sec. 110e(1):

> "A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

Bankruptcy Act, Section 70c, 11 U. S. C., Sec. 110c:—

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

California Civil Code, Section 2957:

> "A mortgage of personal property . . . . is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless

. . . . . .

"4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed. . . ."

Question Presented.

Whether the Court below was correct in holding that the trustee in bankruptcy could avoid in its entirety a chattel mortgage, which, on the date of bankruptcy, was invalid under California law as against certain creditors of the bankrupt.

Statement.

In June, 1954, petitioners sold a machine shop business to the bankrupt, accepting a portion of the price in cash with the balance secured by purchase money chattel mortgage. The security instrument, however, was not promptly recorded as required by California statute, there being a delay of 79 days in filing. The effect of this oversight was to render the mortgage invalid under the state law as against creditors of the bankrupt whose claims arose prior to the tardy recordation.[2] As of the time of bankruptcy, there were still in existence creditors possessing claims of $8,906.95 who could so attack petitioners' security.

In December, 1954, petitioners repossessed the chattel mortgaged assets because of the bankrupt's default in making payments.[3] Bankruptcy occurred on February 23,

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[2]*E.g., Ruggles v. Cannedy*, 127 Cal. 290, 298-302 (1899).

[3]At the time of repossession of the assets in December, 1954, the bankrupt was insolvent and petitioners knew it. [R. p. 66.] Petitioners assert at several places in their brief here that the bankrupt was solvent on the dates the mortgage was executed and recorded.

1955. Thereafter, in March, 1955, petitioners sold the assets for $82,500.00, their then fair value.

Petitioners filed a creditor's claim in the bankruptcy proceeding for the balance owing to them, after allowance to the bankrupt of a credit for the amount received on the foreclosure sale. Relying primarily on Sections 70e and 70c of the Bankruptcy Act, the trustee counterclaimed for $82,500.00, the proceeds of the mortgaged assets which petitioners had sold.

The Referee in Bankruptcy held that the trustee could invalidate the mortgage but only to the same extent that it was subject to challenge under California law by actual creditors on the date of bankruptcy. Accordingly, he rendered judgment in favor of the trustee for $8,906.95. On the trustee's petition for review, District Judge Ben Harrison reversed, holding that Section 70e of the Bankruptcy Act and this Court's decision in *Moore v. Bay*, 284 U. S. 4 (1931), demanded a complete invalidation of the mortgage and a resultant judgment for the trustee in the sum of $82,500.00.

The Court of Appeals affirmed. The effect is to require petitioners to pay back the value of the assets subject to the defective mortgage, at which time they will be entitled to receive dividends as general creditors on a claim for the entire amount then owing to them. (Bankruptcy Act, Secs. 57g, 57n, 11 U. S. C., Secs. 93g, 93n.)

There is nothing in the Record, however, to support such a claim, although the opinion of the Court of Appeals does unfortunately contain a similar error of fact.

In any event, the question of insolvency is immaterial under Sections 70e and 70c of the Bankruptcy Act, the provisions upon which the Court below relied in invalidating petitioners' chattel mortgage. Section 60 of the Act, pertaining to preferences, was not made a ground of the decision. For this reason, insolvency which is an element of a cause of action under Section 60, is now unimportant in the present case.

ARGUMENT:

I.

The Only Federal Questions Involved Are Well Settled. The Decision Below Clearly Is Correct, the Court Having Properly Applied Long Established Controlling Principles.

A. Petitioners' Mortgage Was Completely Invalid as Against the Trustee in Bankruptcy Under Section 70e of the Bankruptcy Act.

As seen above, on the date of bankruptcy petitioners' chattel mortgage was invalid under California law as against certain of the bankrupt's creditors who had claims totaling $8,906.95. Such being the case, Section 70e of the Bankruptcy Act enables the trustee to set aside the security in its entirety.

This section provides, in effect that a transfer or mortgage made by a bankrupt which for any reason is voidable under state law on the date of bankruptcy by any creditor having a provable claim is "null and void" as to the trustee. It is immaterial whether the transfer occurred within four months of bankruptcy or more than four months before, so long as creditors could attack it when the petition was filed.

Section 70e was construed in 1931 in *Moore v. Bay*, 284 U. S. 4, a unanimous decision written for the Court by Mr. Justice Holmes. While the opinion is brief, the record and the reported decision of the lower court[4] leave no doubt what was decided. The case arose in California and involved a chattel mortgage which was partially in-

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[4]In the lower courts, *Moore v. Bay* was carried under the caption *In re Sassard & Kimball*, 45 F. 2d 449 (C. A. 9, 1930).

valid because of failure to comply with the notice filing requirement of former Section 3440 of the Civil Code. The penalty for omitting the notice, like that for tardy recording, was to render the security defective only as against creditors coming into existence before recordation. The argument made in *Moore v. Bay* by the mortgagor's trustee was clearly set forth in the lower court's opinion in that case:

> "It is the contention of appellant [Trustee] that, under section 70e of the Bankruptcy Act . . . the mortgage in question, being void as to one creditor or class of creditors, is void in toto at the suit of the trustee."[5]

The Court of Appeals rejected this contention, holding that the trustee obtained no greater rights than the creditors who could attack the mortgage under state law:

> "There is no express language in this section [70e] which specifically gives to any unsecured creditor of a bankrupt any greater rights or any secured creditor any less right than he had before adjudication in bankruptcy. The rights of a trustee in bankruptcy to 'avoid any transfer' are no greater than those of a creditor or particular class of creditors. It is clear, we think, that a trustee in bankruptcy is limited in his control and disposition of the estate of the bankrupt to the rights of creditors as such rights existed and could be enforced under the state law prior to the time proceedings in bankruptcy were instituted."[6]

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[5] 45 F. 2d at 450.

[6] 45 F. 2d at 450.

After granting the trustee's petition for certiorari, the Supreme Court reversed this decision. Therefore, despite the brevity of the opinion, *Moore v. Bay* necessarily held that the trustee's power under 70e is to invalidate completely a defective transfer, even though it could be attacked only to a lesser extent by the creditor or creditors from whom the power is derived. That is to say, for Section 70e purposes there must exist at least one actual creditor as to whom the transfer is invalid; but once this is established, the *quantum* of the trustee's recovery is not measured by the creditor's rights.[7]

In the more than a quarter of a century which has elapsed since *Moore v. Bay* was decided, no Court of Appeals, Federal District Court or state court has failed to follow the rule that a transfer, voidable in part by creditors of the bankrupt under state law, is completely void under Section 70e of the Bankruptcy Act as against the trustee.[8] A number of cases illustrating the uniformity

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[7]The opinion also announces a second principle, namely, that the recovery thus made by the trustee is to be distributed pro rata to all the bankrupt's creditors in accordance with the distributive scheme of the Bankruptcy Act, and not merely to those claimants who could have challenged the transfer under state law. This second principle, however, is not questioned in the present case.

[8]Congress apparently placed its stamp of approval on *Moore v. Bay* when the following language was added to Section 70e(2) of the Bankruptcy Act in 1938: "All property of the debtor affected by any such transfer shall be . . . discharged and released from such transfer . . . and every such transfer . . . shall be avoided by . . . the trustee. . . ." See also, 4 Collier on Bankruptcy, par. 70.95, p. 1536.

with which the principle has been applied are collected in the footnote below.*

4 Collier on Bankruptcy, Par. 70.95, pp. 1533-1534, comments as follows on *Moore v. Bay*:

> "Since the decision in the *Bay* case, no dissenting voice has been raised by the courts. The accepted rule is that in a suit under §70e if the transfer or obligation is voidable at all, it is voidable *in toto*. Thus where a chattel mortgage, because it was not filed promptly after its execution, is void as against creditors who extended credit to the bankrupt during the interim, it is void as against the trustee in its entirety, regardless of the extent of such interim credit. . . . There can be no doubt that the Supreme Court ruled authoritatively on the matter, for the issue was squarely before the court."

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*Second Circuit: *City of New York v. Rassner*, 127 F. 2d 703, 707 (1942); *American Trust Co. v. New York Credit Men's Adjust. B.*, 207 F. 2d 685, 689 (1953); *Zamore v. Goldblatt*, 194 F. 2d 933 (1952), *cert. den.* 343 U.S. 979.

Fourth Circuit: *Friedman v. Sterling Refrigerator Co.*, 104 F. 2d 837, 840 (1939).

Fifth Circuit: *Corley v. Cozart*, 115 F. 2d 119, 121 (1940).

Sixth Circuit: *General Motors Acceptance Corporation v. Coller*, 106 F. 2d 584 (1939), *cert. den.* 309 U.S. 682; *Trailmobile, Inc. v. Wiseman*, 244 F. 2d 76 (1957); *Oliver Machinery Co. v. Bissell*, 261 F. 2d 596 (1958).

Eighth Circuit: *Mercantile Trust Co. v. Kahn*, 203 F. 2d 449 (1953).

District Courts: *In re Tobias*, 150 F. Supp. 288 (W. D. Mich., 1957); *In re Higgs*, 126 F. Supp. 16 (E.D. Mich., 1954); *Deane v. Fidelity Corporation of Michigan*, 82 F. Supp. 710 (W.D. Mich., 1949); *In re Independent Distillers of Kentucky*, 34 F. Supp. 708 (W.D. Ky., 1940); *In re Johnson*, 23 F. Supp. 337 (W.D. Mich., 1938).

State Courts: *E.g., Tatelbaum v. Nat'l Store Etc. Co.*, 196 Md. 599, 78 A.2d 228 (Ct. of App. Md., 1951).

See also,

1 Glenn, Fraudulent Conveyances and Preferences (Rev. ed. 1940), pp. 567-568.

There is no merit in the attempt to distinguish *Moore v. Bay* on the alleged ground that there the mortgage was "conclusively fraudulent and a nullity against all creditors" (Pet., p. 15), whereas here petitioners' security was invalid under state law only as to creditors whose claims arose before recordation. Not only does this attempt run counter to all the precedents, but also it misstates the California law. For failure to comply with the notice requirements of Section 3440 of the California Civil Code entails exactly the same penalty as failure to promptly record the chattel mortgage under Section 2957: The security becomes subject to attack only by creditors whose claims arise prior to recordation; as to all others, it is invulnerable.[10]

Petitioners are incorrect in asserting that *Buffum v. Peter Barceloux Co.*, 289 U. S. 227 (1933), is inconsistent with *Moore v. Bay*. On the contrary, *Buffum* held that a trustee suing under Section 70e could invalidate a fraudulent pledge transaction which had occurred about eight months before bankruptcy. Sections 70c and 70c of the Act do not contain a four month period of limitations as does Section 60 pertaining to preferences. The

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[10] "It is clear that the mortgage, by reason of the provisions of the statute [Civil Code, Sec. 3440], is void as to creditors of the first class [those whose claims existed on the date the mortgage was executed], and it is conceded it is also void as to those of the second class [those having claims which arose between execution of the mortgage and the time it was recorded]. As held by decisions of the Supreme Court of California, the mortgage would be valid as against creditors of the third class [those whose claims arose after recordation]." (Citing cases.) *In re Sassard & Kimball*, 45 F. 2d 449, 450, *rev'd sub nom. Moore v. Bay*, 284 U.S. 4.

statement by the Court in *Buffum* that the pledge was more than four months old, and hence unassailable if it were only a preference, is consistent with *Moore v. Bay* and the decision below in this case, since it refers to a different section of the Act.

Nor was there anything said or held in *Pepper v. Litton*, 308 U. S. 295 (1939), which is inconsistent with *Moore v. Bay*. *Pepper* concerned the distribution of the assets of an estate and the power of a Bankruptcy Court to subordinate the rights of creditors who had been guilty of fraud or inequitable conduct to claims of other creditors. It had nothing to do with the creation of an estate or the trustee's power to recover transfers or set aside liens, as did *Moore v. Bay*. *Pepper v. Litton* cannot be extended to the present case so as to bring petitioners ahead of the bankrupt's trade creditors who have committed no wrong. Moreover, petitioners' contention in this respect, and the similar equitable lien, estoppel and unjust enrichment theories, were raised for the first time at the oral argument in the Court below, a fact which by itself would require their rejection.

The so-called harshness in this case stems solely from the fact that petitioners neglected to comply with California's legislative policy which demands prompt recordation of mortgages to protect creditors from being victimized by secret encumbrances. Bankruptcy may have magnified to some extent the result of petitioners' carelessness, but they are assumed to have contracted with knowledge of the Federal as well as the State law, and they could have avoided the risk entirely by full compliance with the

filing statute. In this connection, the Fourth Circuit's observation in *Friedman v. Sterling Refrigerator Co.*, 104 F. 2d 837, 841 (1939), a case involving the *Moore v. Bay* principle, is equally applicable here:

> "Reference is made to cases of hardship which might occur as a result of the enforcement of the statute. The answer, of course, is that the vendor should protect himself by prompt recording. If he delays, he takes chances; and he is not relieved because the loss resulting therefrom may be greater than he may have anticipated or because it may have arisen through the creation of obligations by the debtor rather than through his dealing with the property which is the subject of the contract."

B. Section 70c of the Bankruptcy Act Compels the Complete Invalidation of Petitioners' Mortgage.

Although Section 70e alone would suffice, the Court below also applied 70c as an alternative ground to invalidate the security. This latter section, as amended in 1950, permits the trustee to set aside mortgages or other transfers so long as they are invalid as against any hypothetical creditor at the time of bankruptcy. As of that date in the present case, petitioners' mortgage was vulnerable to attack under California law by those who had granted credit to the bankrupt before recordation occurred. Accordingly, the trustee would prevail under Section 70c even if he could not prove, as he must for 70e purposes, that actual creditors had extended credit during the period the mortgage remained off record. Moreover, since the trustee's rights under Section 70c

do not derive from those of actual creditors, there can be no question but that his recovery under this provision involves complete invalidation of the security. Cases so holding are *Constance v. Harvey*, 215 F. 2d 571 (C. A. 2, 1954), *cert. den.* 348 U. S. 913; *Conti v. Volper*, 229 F. 2d 317 (C. A. 2, 1956); and *In re Kranz Candy Co.*, 214 F. 2d 588 (C. A. 7, 1954).

II.

There is No Conflict of Decision.

As seen in Part I of this brief, the principles relied upon by the Court below have been uniformly applied. Petitioners err when they assert that a conflict exists between the decision in the present case and the Third Circuit's holding in *In re Consorto Const. Co.*, 212 F. 2d 676 (1954). The Pennsylvania recording statute involved in the *Consorto* case protects only creditors who actually levy on the chattel mortgaged property prior to recordation, in contrast to the California statute which protects those extending credit prior to recordation, whether or not they obtain their liens prior thereto. Therefore, recordation having taken place in the *Consorto* case before bankruptcy, no hypothetical or actual creditor on that date could prevail in Pennsylvania over the chattel mortgagee, and the trustee accordingly could not rely on either Section 70c or 70e. But the Third Circuit expressly distinguished the California recording statute as construed in *Ruggles v. Cannedy*, 127 Cal. 290 (1899), indicating that a different conclusion would be required if the Pennsylvania law were similar.

Conclusion.

For each and all of the foregoing reasons, it is submitted that the petition for certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. [redacted]97

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, and Executors of the Estate of GEORGE MILLER, Deceased,

Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 981

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, and Executors of the Estate of GEORGE MILLER, Deceased,

Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

REPLY AND SUPPLEMENTAL BRIEF OF PETITIONERS.

Prefatory Comment.

At the outset it is to be noted that the opinion in the *Moore* case (284 U. S. 4, 52 S. Ct. 3, 75 L. Ed. 133) indicates that the respondent therein (the chattel mortgagee) had not entered his appearance in this court and the opinion does not indicate whether an answering brief was filed by the respondent and whether this Honorable Court had the benefit of the respondent's views on the specific legal problem discussed in the *Moore* decision.

It is to be further noted that the opinion of the Court of Appeals in the case at bar is apparently premised on

the legal theory that the bankrupt's creditors who came into existence after the recordation of the Millers' chattel mortgage (recorded more than four months before bankruptcy) *should be placed in the same category and classification* with the bankrupt's creditors who came into existence during the intervening period between the date of the execution of the chattel mortgage on June 1, 1954, and the date of its delayed recordation on August 19, 1954. Petitioners respectfully contend that *classification* of creditors is determinable by the state law, and that creditors coming into existence after the recordation of a chattel mortgage *more than four months before bankruptcy* cannot be placed in the same category with the creditors who came into existence during the intervening period between the date of the execution of the chattel mortgage and the date of its delayed recordation.

We wish to preface the points discussed in this reply and supplemental brief with a brief restatement of the following legal principles firmly established by the recent decisions of this Court and of the California Supreme Court.

1. "Cases are not decided, nor the law appropriately understood, *apart from an informed and particularized insight into factual circumstances of the controversy under litigation*" (*Federal Maritime Board v. Isbrandstern Co.*, 356 U. S. 481, 78 S. Ct. 851, 861, 2 L. Ed. 926; italics added), and "this principle has particular force where the courts are asked to strike down on grounds of public policy a contractual arrangement on its face consensual" (*Southwestern Sugar, etc. v. River Term Corp.*, 78 S. Ct. Rep. 1210 at 1217).

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2. While *in the abstract*, the specific legal problem discussed in the *Moore* decision in its application to the

facts therein particularized involved the construction of a few isolated sections of the Bankruptcy Act, the problem posed by the record in the case at bar involves the construction of the Bankruptcy Act assayed in its entirety and in the light of the philosophy of the Bankruptcy Act in its application to *the equitable factual setting presented by the present record.* The Millers' equities posed by the present record analyzed in the light of the equitable philosophy of the Bankruptcy Act involve a more "perceptive process than is conveyed by the delusive phrase ascertaining the intent of the legislature (to borrow the language of Mr. Justice Frankfurter in *San Diego Building Trades Council v. Garmon,* 79 S. Ct. Rep. 773 at 776-777).

3. In *Gage v. Jordan,* 23 Cal. 2d 794, the California Supreme Court declared in effect at page 800 that where the language of a statutory provision is susceptible of two constructions, one of which in its application to the precise facts presented by the record will render it reasonable, fair and harmonious with the manifest legislative purpose and another which would be productive of unjust consequences, the former construction will be adopted and followed by the courts.

It requires no argument that the legal factual setting in the *Moore* case and the equitable factual setting in the case at bar are poles apart. It seems that the above stated firmly established legal and equitable principles were not given due consideration by the Court of Appeals and by the respondent in his responsive brief filed herein.

This reply and supplemental brief is addressed to the following subsidiary points which are fairly comprised in the statement of the questions presented in the ceritorari petition.

I.

Under the California Substantive Law a Mortgage Is a Contract Under Which the Mortgagee Acquires a Property Interest.

Section 2920 of the California Civil Code reads as follows:

> "Mortgage is *a contract* by which specific property is hypothecated for the performance of an act, without the necessity of a change of possession." (Italics added.)

The primary purpose of a chattel mortgage is to transfer title of personalty to the mortgagee as security for the performance by the mortgagor of his contractual obligation.

> *Bank of California v. McCoy*, 23 Cal. App. 2d 192, 195.

The property interest vested in the mortgagee is in the nature of a lien securing the enforcement of the mortgagor's contractual obligation.

> *Estate of McLaughlin*, 97 Cal. App. 485, 489.

The evolution of the equitable philosophy of the Bankruptcy Act is explicated in the recent decision of this Court in *United States v. Embassy Restaurant, Inc.*, 79 Sup. Ct. 554, wherein the Court stated at page 555 that "the broad purpose of the Bankruptcy Act is to bring about *an equitable* distribution of the bankruptcy estate" and that "*if one claimant is to be preferred over others, the purpose should be clear from the statute.*" (Italics added.)

It is respectfully submitted that there is no language in the Bankruptcy Act tending to support the broad conten-

tion made by the trustee in bankruptcy that Sections 70(c) and 70(e) of the Bankruptcy Act were intended to strike down Millers' property interest in their valid chattel mortgage which the record conclusively shows was executed about eight months before bankruptcy and which the trustee in bankruptcy *concedes* in his responsive brief *was not a preference under Section 60 of the Bankruptcy Act.* Nor is there any language in the *Moore* decision to lend support to the respondent's such sweeping and inequitable contention.

Furthermore, the chattel mortgage involved in the *Moore* case (amplified *infra*) *was conclusively fraudulent against all of the creditors of the bankrupt-mortgagor, including the bankrupt's future creditors; while the mortgage in the case at bar was valid against the future creditors of the bankrupt under the California decisions as stated at page 19 of the certiorari petition.*

II.

The Moore Decision Was Handed Down in 1931, Eight Years Prior to the Enactment of the Uniform Fraudulent Conveyance Act; and Under Section 3440 of the California Civil Code in Force in 1931, the Mortgage in the Moore Case Was Conclusively Fraudulent Against All of the Creditors of the Mortgagor Including His Future Creditors.

The California State law on this point is summed up in 23 Cal. Jur. 2d, Par. 78 at pages 526-527, wherein it is stated:

> "Proscribed transfers of personal property without immediate delivery are 'conclusively presumed fraudulent and void,' as are those made in violation of the bulk sales law. Also, instruments made with

intent to defraud, as described in Civil Code Sec. 1227, are 'void.' But the Uniform Fraudulent Conveyance Act says simply that conveyance within its provisions are 'fraudulent.' In each instance, however, the stated effect is 'as against' creditors or others who are brought within the protection of the statute.

"On the ground that a debtor who makes a conveyance with actual intent to defraud creditors is subject to criminal prosecution, it has been said that such a conveyance is void, not voidable, and that it may therefore be attacked by any creditor, existing or future."

In 24 Am. Jur. at pages 284-285, it is stated:

"The prevailing opinion is that if it is shown that there was mala fides or fraud in fact in the transaction, whether the actual fraudulent intent related to existing creditors or was directed exclusively against subsequent creditors, the effect is precisely the same, and subsequent creditors may, on the strength of such fraud, successfully impeach the conveyance."

On the other hand, the Miller mortgage in the case at bar was valid against the bankrupt's creditors who came into existence following the recordation of the Miller chattel mortgage, which admittedly was a valid chattel mortgage against the bankrupt's subsequent creditors.

It is respectfully submitted that the statement of the Court of Appeals in its opinion that the *Moore* case and the present case cannot be distinguished *in principle* is clearly erroneous under the firmly established rule restated by this Court in *Southwestern Sugar Co. v. River Term*

Corp., supra (at p. 215), that "cases are not decided, nor the law appropriately understood, apart from an informed and particularized insight into the factual circumstances of the controversy under litigation."

Clearly, the bankrupt's subsequent creditors could not be placed in the same category with the bankrupt's antecedent creditors; and to permit the subsequent creditors to share equally with the bankrupt's antecedent creditors would result into an unequitable distribution of the bankrupt's estate and into their unjust enrichment at the expense of the Millers.

III.

The Following Statements in the Responsive Brief of the Trustee in Bankruptcy Require Correction.

1. In footnote 3 at page 3 of his responsive brief, the trustee in bankruptcy asserts that it is not true that the bankrupt was insolvent on the dates the Millers' chattel mortgage was executed and recorded and that the opinion of the Court of Appeals "does unfortunately contain a similar error of fact." We respectfully submit that the respondent's such assertion is gainsaid by the record. The record conclusively shows (a) that on the date of the execution of the chattel mortgage the bankrupt came into possession of Miller's going manufacturing plant of the value of $200,000; (b) that the only existing provable claims against the bankrupt on the date of the recordation of the chattel mortgage on August 19, 1954, totalled the sum of $8,906.95 [R. p. 56]; and (c) that the only finding made by the Referee was that the bankrupt was insolvent on or about December 27, 1954, at the time of the repossession by the Millers of the mortgaged property [R. p. 56].

2. At page 8 of his responsive brief, the respondent cites the statement in 4 Collier on Bankruptcy, Par. 70.95, pages 1553-1554, that "Since the decision in the Bay case, no dissenting voice has been raised by courts" and that the *Bay* decision is equally applicable to the facts in the case at bar. We respectfully submit that this point has been adequately covered in the petition for certiorari at pages 20-21 and 24.

3. The assertion made by the respondent at page 9 of his responsive brief that the *Buffum* case (289 U. S. 227) did not modify the holding of this Court in the *Moore* case disregards the statement of Mr. Justice Cardozo that a pledge perfected more than four months before bankruptcy was not subject to an attack by the trustee in bankruptcy *in absence of proof that the pledge was fraudulent in its inception.*

4. At page 12 of his responsive brief the respondent states that there is no conflict between the opinion of the Court of Appeals in the instant case and the decision of the Third Circuit in *In re Consorto Construction Co.*, 212 F. 2d 676. We respectfully submit that the respondent's attempted distinction of the *Consorto* case *supra* is a distinction without a difference. It will be noted that the Pennsylvania Recordation Statute, like the California Recordation Statute, states no time within which recordation must be effected (p. 678 of the opinion). We respectfully submit that the equities in the case at bar cannot be distinguished from the equities in the *Consorto* case *supra* and that the approach made in the *Consorto* case *supra* is realistic in the light of Section 57(K) of the Bankruptcy Act and in the light of the equitable principles of estoppel *in pais* discussed in the certiorari petition which latter

principles we respectfully contend were not respected by the respondent in any manner other than by ignoring them.

Conclusion.

Assuming that the *Moore* decision may be considered as a precedent under the doctrine of *stare decisis* in its application to the present record we respectfully submit that the *Moore* decision raises grave constitutional questions as lucidly pointed out by the Referee in his memorandum opinion [R. pp. 36-37].

As stated by Mr. Justice Black in his dissenting opinion in *United States v. Green*, reported in 78 of the Sup. Ct. Rep. at page 649 (with which the majority of the court was not in disagreement):

> ". . . Ordinarily it is sound policy to adhere to prior decisions but this practice has quite properly never been a blind inflexible rule. Courts are not omniscient. Like every other human agency, they too can profit from trial and error, from experience and reflection. As others have demonstrated, 'the principle commonly referred to as *stare decisis* has never been thought to extend so far as to prevent the courts from correcting their own errors. Accordingly, this Court has time and time again from the very beginning reconsidered the merits of its earlier decisions even though they claimed great longevity and repeated reaffirmation.' (Cases cited.). Indeed, the Court has a special responsibility where questions of constitutional law are involved to review its decisions from time to time and where compelling reasons present themselves to refuse to follow erroneous

precedents; otherwise its mistakes in interpreting the Constitution are extremely difficult to alleviate and needlessly so. (Cases cited.)"

Respectfully submitted,

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Motion of Petitioners for Leave to Append to Their Reply and Supplemental Brief Article of Professor MacLachlan of Harvard Law School.

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Motion of Petitioners for Leave to Append to Their Reply and Supplemental Brief Article of Professor MacLachlan of Harvard Law School.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners respectfully move for leave to append to their reply and supplemental brief the articles of Professor MacLachlan of Harvard Law School at pages 330 to 333, inclusive, in his Bankruptcy Handbook Series published in 1956.

This motion is made for the following reasons:

1. The attention of petitioners' counsel to this article was drawn the first time following the filing of petitioners' reply and supplemental brief; and for this reason said article has not been referred to in petitioners' reply and supplemental brief.

2. The comments of Professor MacLachlan in said appended article would be helpful to this Court in its resolution of the principal questions presented for review in their certiorari petition *upon the present record.*

3. Said comments reinforce petitioners' major contention that the abstract principles expounded in *Moore v. Bay* (284 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133) merit critical reconsideration by this Court in their application to the present record; and for the reasons set forth in the certiorari petition the abstract and generalized principles set forth in the *Moore* decision must be fully briefed and orally argued in the light of the equities presented by the present record.

Respectfully submitted,

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APPENDIX.

Comment of Professor MacLachlan on Moore v. Bay.

284. An ill-considered decision has established the law to the effect that a transfer vulnerable in minor part only outside of bankruptcy becomes completely invalid in the event of bankruptcy. Recoveries are properly held to be general assets of the bankruptcy estate.

The scope of section 70e is, however, clouded by one of the most glaring misconstructions to be encountered in the history of Anglo-American law. The result must be attributed in large part to the fact that the decision was made on reversing a judgment of the Circuit Court of Appeals without the benefit of argument on the part of the respondent. Mr. Justice Holmes,[1] then over 90 years

[1] In view of the high regard in which this Justice is held, it may seem graceless to record the opinion that in commercial law and several related fields he made a disproportionate number of decisions open to challenge as technically unsound or unrealistic. Some of these decisions have been repudiated by the court: Francis v. McNeal, 228 U. S. 695, 33 S. Ct. 701 (1913); Flexner v. Farson, 248 U. S. 289, 39 S. Ct. 97 (1919); Baltimore & O. R. Co. v. Goodman, 275 U. S. 66, 48 S. Ct. 24 (1927); some by Congress: United States v. Johnson, 221 U. S. 488, 31 S. Ct. 627 (1911); Davis v. Pringle, 268 U. S. 315, 45 S. Ct. 549 (1925); Sexton v. Kessler & Co., 225 U. S. 90, 32 S. Ct. 657 (1912). Others remain to require undesirable results which cannot be reconciled with more generally accepted principles: Die Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U. S. 517, 47 S. Ct. 166 (1926); United States Fidelity & Guaranty Co. v. Woodridge, 268 U. S. 234, 45 S. Ct. 489 (1925); Eaton v. Boston Safe Deposit & Trust Co., 240 U. S. 427, 36 S. Ct. 391 (1916). Concerning the abandonment of the Flexner rule, see Sugg v. Hendrix, 142 F. 2d 740, 742 (C. C. A. 5th, 1944). His fine brief literary style helped him to evade or to elide brilliantly the considerations that should have controlled the case. The force of his personality may well have helped him to lead his colleagues as well as to dominate the procession of brilliant young men who acted as his clerks. Those who ignore his technical decisions and attack his philosophy attack him where his reputation rests upon a far firmer foundation. One

old, stated the facts in two sentences and the procedure below in one, and the law in five more. The opinion thoroughly concealed the critical point of the case. An examination of the record leads to the conclusion that the Court did not grasp the point and did not understand the effect of its decision. The Court said: "The bankrupt executed a mortgage of automobiles, furniture, showroom, and shop equipment that is admitted to be bad as against creditors who were such at the date of the mortgage and those who became such between the date of the mortgage and that on which it was recorded, there having been a failure to observe the requirements of the West's Ann. Civil Code of California, Par. 3440 (a recording act). The question raised is whether the mortgage is void also as against those who gave the bankrupt credit at a later date, after the mortgage was on record." This is a serious misstatement. The record shows that there were two questions, but this was not a proper statement of either. The questions were: (1) whether the trustee in bankruptcy could appropriate all the mortgaged property or whether his right to attack it was measured by the claims of creditors who could attack it. (2) Assuming that his recovery was the more limited one (as all previous cases had assumed), was his recovery to inure only to the direct benefit of the creditors who could attack or did it become a general asset of the estate?

The Court then said: "The Circuit Court of Appeals affirmed an order of the District Judge giving the mortgage priority over the last creditors. (45 F. 2d 449.)"

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of his earliest opinions upon the United States Supreme Court, his dissent in Northern Securities Co. v. United States, 193 U. S. 197, 24 S. Ct. 436 (1914), suggests searching thought, but both the theory and the result he propounded were properly rejected by the Court both then and later.

This obscures the issues. The courts below soundly held (1) that the trustee could claim an interest in the mortgaged property measured by the claims of the creditors who could claim priority over the mortgage, and (2) that his recovery became general assets.

The Court then said: "Whether the court was right must be decided by the Bankruptcy Act, since it is superior to all state laws upon the subject. Globe Bank v. Martin, 236 U. S. 288, 298, 35 S. Ct. 377." This is a misleading oversimplification. The Bankruptcy Act here expressly refers back to state law for the basis of the trustee's right.

The next sentence of the opinion reads: "The trustee in bankruptcy gets the title to all property which has been transferred by the bankrupt in fraud of creditors or which prior to the petition he could by any means have transferred, or which might have been levied upon and sold under judicial process against him. Act of July 1, 1898, c. 541, sec. 70." This is comparatively innocuous. The trustee cannot prevail under section 70a, however, and a statement of its terms here is only a distraction. The reference to fraud on creditors, section 70a(4), adds to the distraction, for as we have seen, this clause is not self-executing, speaks only as of the date of the petition, and gives the trustee less effective rights than section 67d (then section 67e), which is not here in issue.

The Court then said: "By section 67 . . . claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt, shall not be liens against his estate." The reference to section 67 comes closer to giving a basis for the decision than any other part of the opinion. The subdivision was later dropped from section 67 in the

Chandler Act revision, because (with the possible exception of this case) it had never been used to cover any ground not more effectively covered by other provisions. On its face it said that claims which were not valid liens against creditors in general were not to be valid liens against the bankrupt estate. It did not say that a claim which was invalid against any creditor should be completely invalid against the estate regardless of the amount of the claim of the creditor entitled to prevail over it. Such a construction might amount to a forfeiture of a large claim on account of trivial flaw. No hint of such construction had ever appeared.

The Court then said: "The rights of the trustee by subrogation are to be enforced for the benefit of the estate." The source of this statement is uncertain. No such provision was contained in section 67a. There was a provision for subrogation in section 67c then in force in relation to liens by legal proceedings, but that was inapplicable. If the Court was thinking of section 70e, which was really the basis for the trustee's recovery, it was awkwardly but correctly deciding the second point at issue. The trustee asserting a creditor's right to avoid a transfer under section 70e is in effect subrogated to that right. It is preferable to hold that he recovers for the direct benefit of the estate, although it would not be stultifying for him to recover a substantial interest for a large creditor when there are other assets in the estate, for the resulting diminution of that creditor's claim would go to increase dividends for all other creditors.[2] Never-

[2] If there are no other assets, the creditors other than the one having the right of avoidance will gain nothing by a suit. Assume a $1,000 transfer voidable by "C" a creditor with a $1,000 claim, $9,000 other creditors, and $5,000 other assets. "C" will get a

theless, in a large portion of cases it would not pay the trustee to litigate for such an indirect benefit.

The opinion concluded with the final statement: "The Circuit Courts of Appeals seem generally to agree, as the language of the Bankruptcy Act appears to us to imply very plainly, that what is thus recovered for the benefit of the estate is to be distributed in 'dividends of an equal percentum (. . .) on all allowed claims, except such as have priority or are secured.' Bankruptcy Act, sec. 65. In re Kohler (C. C. A.), 159 F. 871; Muller v. Warner (C. C. A.), 11 F. 2d 62; Campbell v. Dalbey (C. C. A.), 23 F. 2d 229; Cohn v. Schultz (C. C. A.), 43 F. 2d 340; Globe Bank & Trust Co. v. Martin, 236 U. S. 288, 305, 35 S. Ct. 377."[3] The Circuit Courts of Appeals did not agree. (Mullen v. Warner, *supra*, deciding in 1923, that recovery was not to be for the direct benefit of the particular creditor only, gave rise to a split of authority[4] which afforded a legitimate reason and apparently the only legitimate reason for bringing the case to the Supreme Court on certiorari.) The judgments of the Circuit Court of Appeals and the District Court in the Moore case were now reversed, the decision being understood to authorize the trustee in bankruptcy to appropriate the entire property free of the mortgage.

$500 dividend if there is no suit, a $600 dividend if the recovery is for the direct benefit of the estate, as against his full $1,000 under the other rule. The other creditors will get $4,500 if no suit, $5,000 if the recovery goes to "C" eliminating his participation in the other assets, and $5,400 if the recovery is for the direct benefit of the estate. The more prosperous the estate the more tolerable a suit for the direct benefit of "C" only.

[3]Followed on this point: In re L. H. Lewis Co., 62 F. 2d 353 (C. C. A. 5th, 1932), and many other cases.

[4]*Contra*: American Trust & Savings Bank v. Duncan, 254 Fed. 780 (C. C. A. 5th, 1918).

An unfortunate circumstance that contributed to this extraordinary result was the absence of any evidence in the record to show what was at stake in dollars and cents. Perhaps the claims of the creditors entitled to disregard the mortgage covered most of the value of the property. Perhaps that is why the mortgagee, after winning in the District Court and the Circuit Court of Appeals, did not think it worth while to go to the expense of defending his interest in the Supreme Court (especially since almost any bankruptcy lawyer would have advised him that the petition of the trustee for a greater recovery was altogether untenable). There is no evidence that the trustee here invalidated a large mortgage through asserting the claim of only a small creditor.